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a. The Venezuelan Economy During President Perez' First Year in Office

Venezuela is taking advantage of high world oil prices to reduce petroleum production while using its still huge oil revenues to promote economic diversification. The influx of oil funds has had relatively little internal economic impact as programs have been slow in getting under way.

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Oil Policy

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Venezuelan petroleum reserves have declined steadily in recent years because the government has permitted little exploration. Oil reserves have declined 20% in the last decade to about 14 million barrels -- enough to support output for only 16 years at the 1975 extraction rate. To help conserve reserves, Caracas reduced oil output by 11.6% in 1974 to 3.0 million b/d and intends to cut another 20% in 1975. Oil receipts which amounted in 1974 to $8.6 billion probably will slip to about $7.8 billion this year.

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President Perez has presented a bill to congress to nationalize private oil company properties this year. Most of the properties would have reverted to the state in 1984-85 under terms of the 1971 Petroleum Reversion Law. After nationalization, a two-three year transition period will be required for the full transfer

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of control to the government. Private companies, under contract to the government, will remain the primary source for advanced technology and marketing networks.

Domestic Programs

Perez is proceeding cautiously with domestic spending to limit disruption of skyrocketing oil revenues to the economy and to assure well-conceived programs. Nevertheless, government domestic spending jumped about 50% in 1974 to $5.1 billion and may rise 25% to 35% this year (see Table 1). Expenditures grew most rapidly toward the end of 1974 after the Perez government, inaugurated in March, developed its spending plans. Much of last year's increase apparently went for higher government salaries and an acceleration of public investment projects already in progress. The government also enlarged spending on social services and provided subsidies for low cost housing construction to give immediate benefit to consumers. Import subsidies for foodstuffs are being increased, partly to reduce domestic inflationary pressures. Although authorizations were made for an additional $1.5 billion to $2 billion in new industrial ventures and economic infrastructure, and long-term credits for private manufacturing and agricultural expansion, there is little evidence of significant disbursements. Some of these projects will get under way in 1975. The $4.9 billion

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government cash surplus in 1974 will probably drop to some $2.8 billion this year.

The initial step in President Perez' economic diversification efforts is the 1 January 1975 nationalization of US-owned iron ore properties which have been supplying about 11% of US iron ore needs. Caracas plans to gradually shift iron ore production to support accelerated expansion of domestic steel capacity. Oil revenues also are to finance expansion of agriculture and manufacturing industries to replace present imports.

Foreign Aid

To sidetrack consuming country complaints about high prices and to put its cash surplus to profitable use, Caracas is extending increasing amounts of foreign aid, mostly on commercial terms. Some $1.8 billion has been committed or pledged to multilateral agencies, and about $300-$500 million has been offered to the six Central American countries to finance oil purchases (see Table 2). Little has been disbursed against these commitments thus far.

Economic Impact

The influx of oil funds has not yet had a substantial economic impact. GNP growth slipped slightly in 1974 according to Central Bank data calculated in constant prices. The slowing reflected the reduction of oil output and some slackening of private capital spending because of business uncertainty. Inflationary pressures were restrained in 1974 by the large government surplus and a 65% gain in the value of imports, the latter consisting mainly of capital and intermediate goods. Nevertheless, the inflation rate about doubled to 12% in the first 11 months of the year, largely because of higher prices for imports.

Higher oil prices boosted the trade surplus to $5.9 billion in 1974 (see Table 3). Net capital outflows, largely the transfer to US banks of funds from the newly established Venezuelan Investment Fund, a $200 million advanced payment on the $900 million foreign debt, and the small foreign aid disbursements, rose to $800 million in contrast to a small inflow the previous year. Thus, the balance of payments moved to a $4.1 billion surplus last year, pushing foreign reserves on 31 December to more than $6.5 billion.

b. The government has purposely slowed the disbursements from the Special Funds to limit the adverse economic impact and to ensure that the expenditure will be on productive and efficient programs. In the near future, as a result, the impact on agriculture, mining, and industry will be small. For example, agricultural imports will remain large in the next few years, particularly with the encouragement of increased import subsidies.

c. Venezuelan plans for oil nationalization call for up to a two-three year transition period after the official transfer of assets. A similar year-long transition period is now underway in the iron ore industry. Even after the transition period, a continuing relationship with the companies is foreseen. This is particularly important in the oil industry for maintaining access to advanced technology and the major's extensive marketing networks. President Perez insisted on the inclusion of Article 5 in the oil nationalization bill to provide a vehicle for such a continuing contractual relationship. This program may well provide a method for a smooth transition in the iron ore and oil industries.

d. Oil exports from Venezuela to Cuba are in the interests of all the parties. Venezuela is interested in diversifying the markets for its oil, as well as extending its influence in the Caribbean. At the same time, the Soviet Union and Cuba would save on transportation costs. It would also enable Moscow to divert tankers to more lucrative uses elsewhere. Cuba may also be interested in diversifying its sources of oil. We have no evidence that negotiations for such a transaction are occurring, however. Recent government to government oil deals worked out by Venezuela suggest that any sales will be made at the market price, although credit terms can be arranged.

c. Venezuelan businessmen appear to have adopted a "wait and see" attitude concerning the impact of Venezuela's membership in the Andean Pact on the business situation. This hesitant attitude was an important factor in the sharp drop in construction activity last year. Businessmen are interested in relaxation of the Andean Pact foreign investment code -- particularly the 14% limitation on profit remittances. The government, on the other hand, is not now disposed to seeking a revision of the code and is seeking Chile's acquiescence to code provisions.

Table 1

Venezuela: Economic Indicators

Oil Receipts

	Billion US $
1972	1.8
1973	3.0
1974	8.6
1975 (Projected)	7.8

Inflation Rate

	Percentage Change Over Previous Year
1972	3.3
1973	5.3
1974	12.2

Government Authorized Expenditures and Revenues 1/

			Billion US $
	Expenditure	Revenues	Surplus or Deficit
1972	2.8	2.8	Negl.
1973	3.4	3.7	0.3
1974 2/	5.1	10.0	4.9
1975 2/	6.5	9.3	2.8

Economic Growth Rate

	Percentage Change Over Previous Year
1972	5.5
1973	5.9
1974	5.7

1. Excluding the Investment Fund and the Special Fund.
2. Estimated.

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Table 2

Venezuela: Foreign Aid

Million US $

	Committed or Pledged	Disbursed
Multilateral		
IMF	540	358
IDB	500	None
IBRD	500	300
Andean Development Corporation	60	None
Central American Development Bank	40	None
Coffee Producers' Fund	60-80	None
UN Special Account	80	30
Caribbean Development Bank	10	None
Other		
Central America	300-500	None
Guyana	16	N.A.
Total	2,106-2,326	688

Table 3

Venezuela: Balance of Payments

Million US $

	1973	Estimated 1974
Exports	5,573	10,500
Oil	5,294	10,150
Non-oil	279	350
Imports (f.o.b.)	-2,840	-4,600
Trade balance	2,733	5,900
Net services	-2,298	-1,000
Current account balance	435	4,900
Capital account (net)	108	-791
Balance of payments and change in reserves	543	4,109

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